

McKinsey Consumer & Shopper Insights



Meet the 2020 Chinese Consumer



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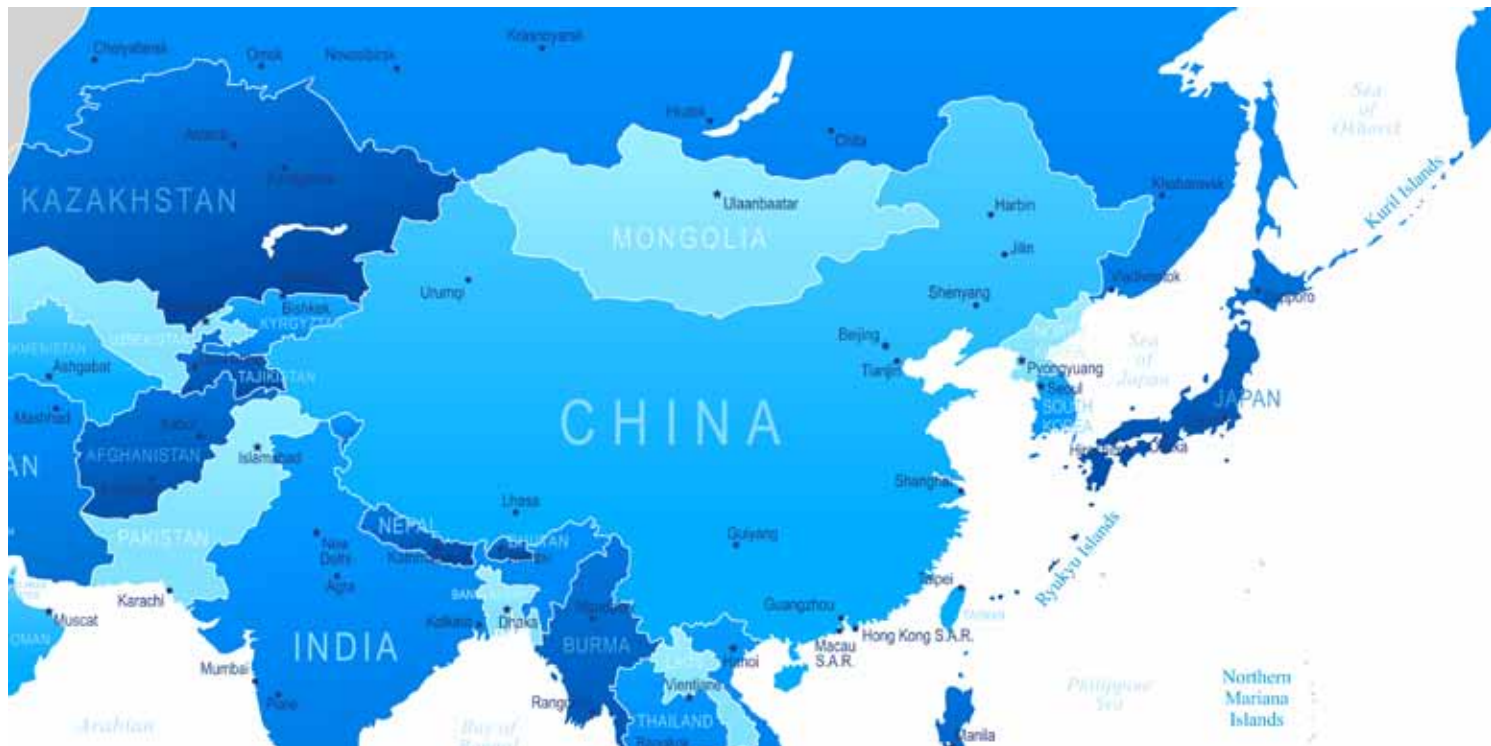
Introduction

Most large, consumer-facing companies have long realized that they will need China's growth to power their own in the next decade. But to keep pace, they will also need to understand the economic, societal, and demographic changes that are shaping consumers' profiles and the way they spend. This is no easy task, not only because of the fast pace of growth and subsequent changes being wrought on the Chinese way of life, but also because there are vast economic and demographic differences across China. These are set to become more marked, with significant implications for companies that fail to grasp them. In the next decade, we believe yawning gaps could open up between companies that have similar sales turnover today but display different levels of focus on the best growth opportunities for the future.

Since 2005, McKinsey has conducted annual consumer surveys in China, interviewing in total more than 60,000 people in over 60 cities.¹ The surveys have tracked the growth of incomes, shifting spending patterns, rising expectations—sometimes in line with the respondents' western counterparts and sometimes not—and the development of many different consumer segments. Those surveys now provide insights to help us focus on the future. We cannot, of course, predict it with certainty. And external shocks might confound any forecast. But our understanding of consumer trends to date, coupled with our analysis of the economic and demographic factors that will further shape these trends in the next decade, serve as a useful lens through which to contemplate 2020.

We do not claim to paint a complete picture of the 2020 consumer. Rather, this report points to those traits likely to influence the way companies ride the next wave of growth in China's consumer market.

¹ The latest survey, carried out in 2011, gauged Chinese consumers' attitudes and spending behavior in relation to about 60 types of products and 300 brands. The respondents represented a wide range of incomes, ages, regions, and cities. They accounted for 74 percent of China's total GDP and for 47 percent of the total population.



China at a Turning Point

China is at an historic turning point. Between 2000 and 2010, its economy tripled in size, ousting Japan to become the world's second largest after the United States. Investment was the biggest driver of growth, while private consumption declined, from 46 percent of GDP in 2000 to 33 percent in 2010. Signs of slower growth globally then raised questions about China's momentum: whether growth could continue over the next decade and from where it would come.

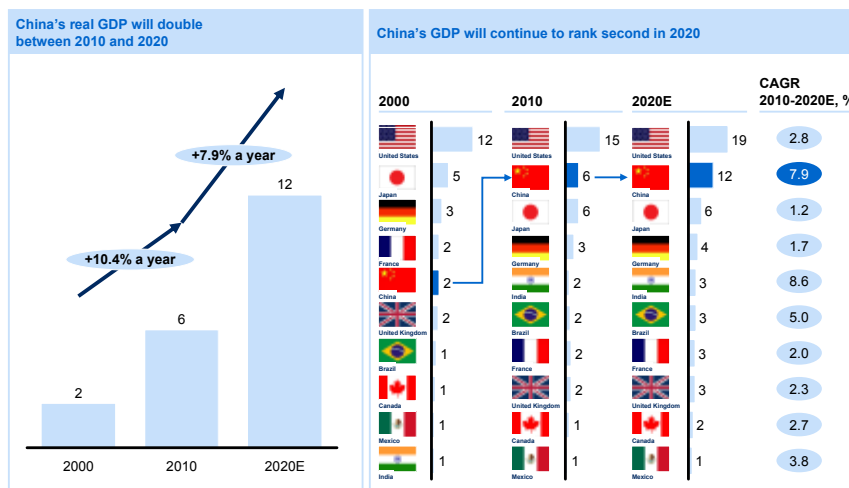
Research undertaken by McKinsey suggests that, barring major world economic shocks, China's GDP will indeed continue to grow, at an annual rate of some 7.9 percent over the next ten years compared with 2.8 percent in the United States and 1.7 percent in Germany (Exhibit 1). The difference henceforth is that consumption, rather than investment, will be the driving force. It will account for 43 percent of total GDP growth by 2020, compared with a forecast contribution from investment of 38 percent.

Exhibit 1

China's continuing GDP growth

\$ trillions, 2010 real term

TOTAL CHINA



Note: Exclude the impact of foreign exchange rate

Source: McKinsey Insights China – Macroeconomic model update (March 2011); Global Insight

This level of growth means that, by 2020, Chinese GDP will account for 19 percent of world economic output, compared with 9 percent in 2010, potentially closing the gap with the United States. However, GDP per capita will remain relatively low for some time to come. It is forecast to be the equivalent of \$9,000 across the total population, compared with \$57,000² in the United States in 2020.³

Transition from investment-led to consumption-led growth will depend on several factors: continuous rapid urbanization, government measures to improve social security and boost private consumption, and financial sector and industrial reforms that will lead to the creation of service sector employment and increase incomes.

The current rate of urbanization is likely to be maintained. By 2020, some 850 million people, representing about 60 percent of the total population, will be living in urban areas, up from about 650 million⁴ in 2010. Around 20 percent of these 850 million will be first-generation migrants from rural areas. The process of urbanization fuels the growth of the consumer market by widening the affordability and availability of goods.

Aggressive measures to boost private consumption are a key plank of the latest five-year plan drawn up by a government anxious to rebalance the economy and so secure more sustainable growth. The historic shortfall in consumption has been largely attributed to three causes: the high rate of saving owing to people's concerns about the social safety net, low household incomes, and the structural focus on investment. Sets of policies have been or will be launched to remove these constraints in the short and long term. Take social security. Concerns about how to pay for health care and retirement have thus far accounted for high personal savings. But the government is committed to extending social security by, for example, increasing retirement pension coverage in urban areas by 40 percent from 250 million people to 350 million by 2015. In respect of investment, continued industrial and financial reform could increase investment-related sources of income, while the evolving service sector will create more jobs and higher incomes. Both developments will promote private consumption.

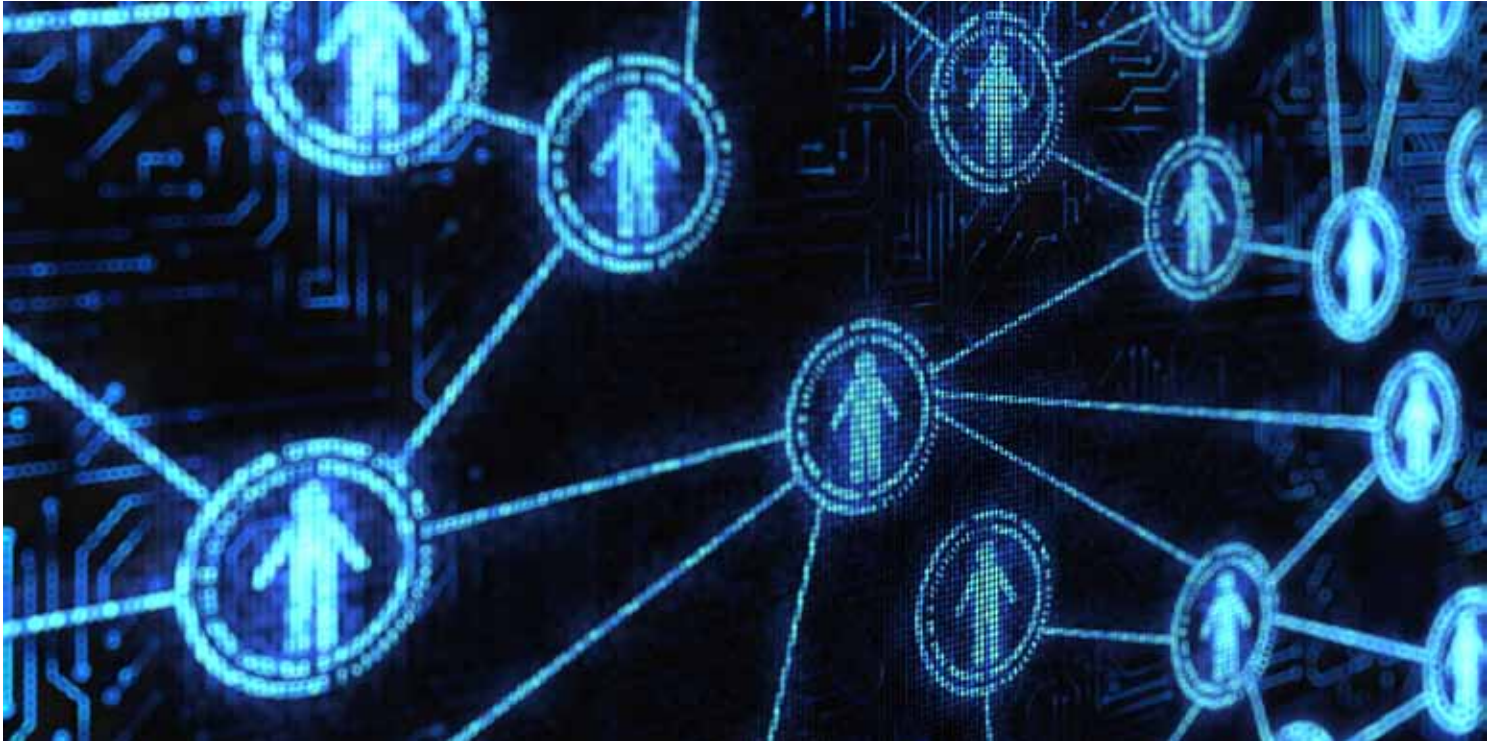
² Source: Global Insight.

³ In 2010 real terms. This applies to all \$ and RMB figures in this report, unless stated otherwise.

⁴ Source: 2010 population census by National Statistics Bureau.

The expansion of China's economy will be concentrated largely in its burgeoning cities—14 of which will appear on the list of the world's top 25 cities in terms of absolute GDP growth for the next decade. By 2020, the GDP of some clusters of cities⁵ will be similar to that of some developed markets currently. The GDP of the Chengdu cluster—a region of 29 cities in western China—will equal that of Austria in 2010, while the GDP of the Shandong byland cluster will equal South Korea's present GDP. By 2020, GDP growth in the Shandong byland will match that of Belgium.

5 Segmentation by city cluster is a practical method of defining China's many discrete markets by reference not only to geography or city tier, but also to less tangible concepts such as income, dialect, economic and trade links, and common consumer attitudes and preferences. See McKinsey's 2009 consumer report: "One country, many markets—targeting the Chinese consumer with McKinsey ClusterMap".



Getting the Basics Right: Changing Demographics

How are these factors altering the demographic profiles of consumers? Many of the changes taking place are common features of rapid industrialization: rising incomes, urban living, better education, postponed life stages, and greater mobility, for example. Japan saw similar changes in the 1950s and 1960s, as did Taiwan and South Korea in the 1980s.

But there are also some unique factors at work, such as the government's one-child policy and the marked economic imbalances among regions. Our analysis reveals some important insights into the likely demographic and socio-demographic profiles of Chinese consumers in 2020.⁶

Mainstream consumers driving income growth

Changes in economic profiles have been and will continue to be the most important trend shaping the consumer landscape. The Chinese are certainly getting richer fast: per capita disposable income⁷ of urban consumers will double between 2010 and 2020, from about \$4,000 to about \$8,000. That will be close to the current standard of living in South Korea but still a long way from that in some developed countries such as the United States (about \$35,000) and Japan (about \$26,000).

⁶ We focus on urban consumers only in this report.

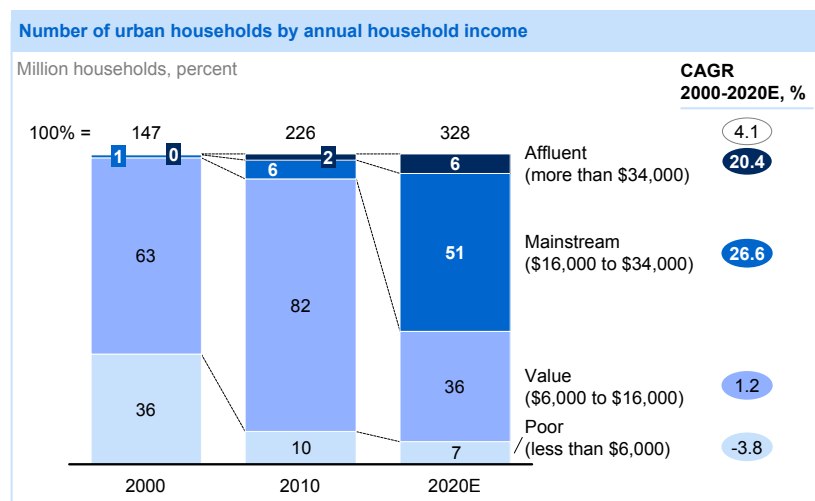
⁷ Disposable income refers to the actual income at the disposal of members of the households which can be used for final consumption, other non-compulsory expenditure and savings. This equals to total income minus income tax, and personal contribution to social security.

The current vast differences in income levels will persist, however, although the numbers at each level will shift dramatically (Exhibit 2). The great majority of the population at present consists of “value” consumers—those living in households with annual disposable income of between \$6,000 and \$16,000 (equivalent to RMB37,000 to RMB106,000), which is just about enough to cover their basic needs. “Mainstream” consumers, relatively wealthy households with annual disposable income of between \$16,000 and \$34,000 (equivalent to RMB106,000 to RMB229,000), form a very small group by comparison. There are fewer than 14 million such households, representing only 6 percent of the urban population. A tiny group of “affluent” consumers, whose household income exceeds \$34,000, comprises only 2 percent of the urban population, or 4.26 million households.

Exhibit 2

Rise of the mainstream consumer

URBAN CHINA



SOURCE: McKinsey Insights China – Macroeconomic model update (March 2011)

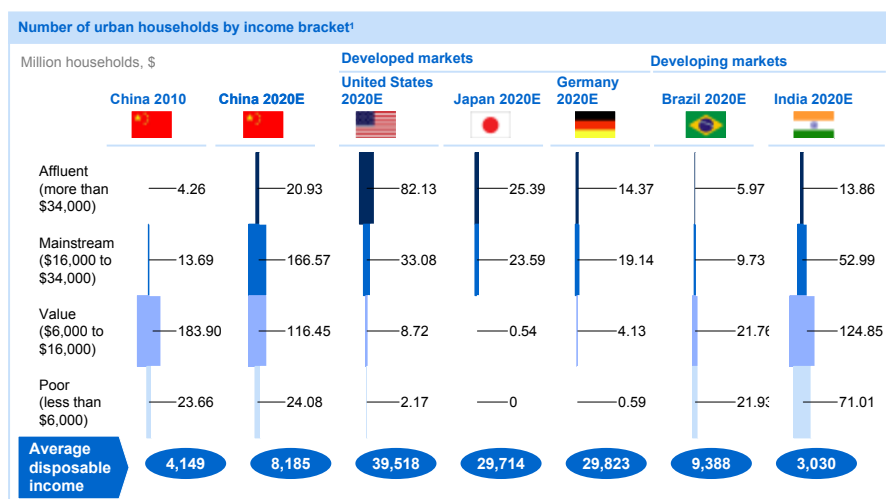
Until now, these divergences have presented multinational companies operating in China with a choice: to target mainstream and affluent consumers only, or to stretch their brands to serve value consumers. Those that took the first course were more or less able to maintain the business model they applied in other parts of the world without needing to de-engineer their products. But in so doing they were limited to a target market of 18 million households. Companies that chose to serve the value category have had a much bigger market to play with, of 184 million households, but their products have had to be cheaper, they have had to adapt their business models, and profitability has been lower.

This situation is changing. Because the wealth of so many consumers is rising so rapidly, many value consumers will have joined the mainstream by 2020. Indeed, mainstream consumers will then account for 51 percent of the urban population. Although their absolute level of wealth will still be quite low compared with that of consumers in developed countries, this group, comprising 167 million households or close to 400 million people, will become the standard setters for consumption, able to afford family cars and small luxury items. Companies will be able to respond by introducing better-quality products to a vast group of new consumers, differentiating themselves from competitors and earning higher profits. Nevertheless, value consumers, reduced to 36 percent of urban households in 2020 from 82 percent in 2010, will still represent an enormous market for cheaper products: 116 million households or 307 million consumers.

Affluent consumers will remain an elite minority, making up only 6 percent of the population in 2020. (In the United States in 2010, more than half the population fell within the income bracket of \$34,000 or above.) But that 6 percent will translate into about 21 million affluent households, or 60 million affluent consumers. Exhibit 3 shows the numbers of Chinese households by income level compared with other countries.

Exhibit 3

Numbers of Chinese households by income level compared with other countries



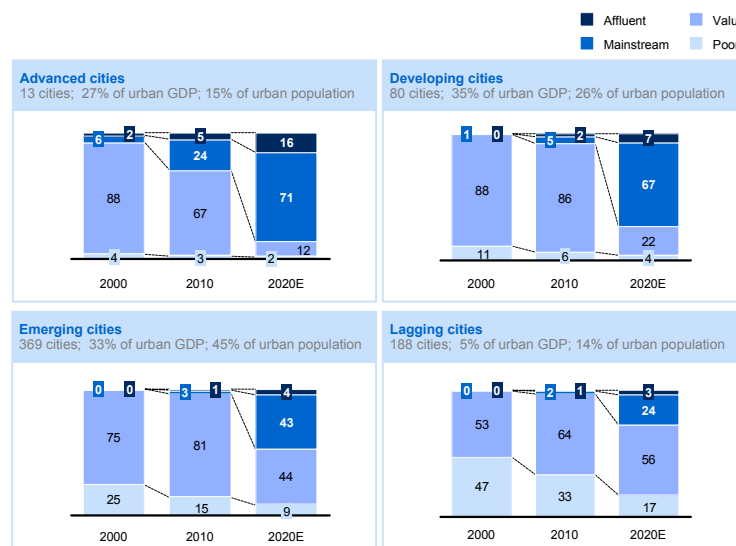
SOURCE: McKinsey Insights China – Macroeconomic model update (March 2011); Canback Dangel for United States, Japan, Germany and Brazil data

While income is expected to rise across China, some cities and regions are already significantly wealthier than others. Understanding these variations in the rate of development is important because they will affect which categories of goods and services grow most rapidly and where. Currently, around 85 percent of mainstream consumers are living in the top 100 wealthiest cities. Another 10 percent of mainstream consumers live in the next 300 cities today, but this percentage will swell to nearly 30 percent by 2020. By then, many families in these cities will be able to afford a range of goods and services, such as flat-screen televisions and overseas travel, that at present are within reach of consumers living in only the wealthiest cities. Exhibit 4 explains the distribution of income in four different groups of cities. It is worth noting that although some cities are small in terms of absolute GDP or population size (Foshan in Guangdong, for example), the affluence of their populations could make them as attractive to companies as leading tier-one cities such as Shanghai and Shenzhen.

Exhibit 4

Income distribution and evolution across cities

URBAN CHINA



SOURCE: McKinsey Insights China – Macroeconomic model update (March 2011)

Aging population

China is an aging society as life expectancy rises and birth rates fall—the latter the result of the one-child policy that was introduced in the 1970s and remains partly in effect today. Only ethnic minorities are allowed more than one child, although the policy was recently relaxed to allow families in which both parents are single children to have a second baby.⁸

Assuming this policy holds, the population's median age will rise from 34 to 37 over the coming decade, similar to the median age of 36.6 in the United States in 2010. At the same time, the proportion of the population over 65 will rise from 10 to 15 percent. This remains low compared with developed countries such as Germany (31 percent) and Japan (34 percent) but it still imposes a heavy economic burden on younger working people.

As is always the case in China, there will be marked regional differences. In six of China's 22 city clusters—Shanghai, Jingjinji, Nanjing, Changchun-Haerbin, Liao Central South, and Chongqing—20 percent of the population will be over 65 by 2020. In five other clusters, however—Guangzhou, Shenzhen, Nanning, Kunming, and Fuzhou-Xiamen—the majority will be under 34. Several reasons account for this: some clusters have attracted large numbers of young migrants looking for what is mainly labor-intensive work; others are poorer and so life expectancy is lower; and in some places the one-child policy is not strictly enforced.

⁸ This came into effect in all 31 provinces in November, 2011.

Postponed life stages

Along with higher incomes, Chinese people have high expectations in other aspects of life. In 2010, around 25 percent of high school students enrolled in college. In 2020, this number could reach 40 percent.

To obtain a good education and a job, young people are willing to postpone marriage and having a family. In the past ten years, the average age at which women have had their first child has risen from 24 to 27. If the trend continues, it will be close to 30 in 2020—the marrying age in many developed countries.

More time spent in education and bachelorhood means more time for recreation, entertainment, and travel. And it means people have more time to spend with friends and colleagues, changing the tone of family relationships as peers become increasingly influential. In Shanghai, the average household size fell from 2.8 people to 2.5 between 2000 and 2010, with approximately half of all households now consisting of just one generation, and 40 percent of two generations. Only 10 percent of households had three generations living together in 2010. All of these factors affect how money is spent.

Increasingly independent women

China's one-child policy, and the importance that many couples still place on having a son, has created a gender imbalance. By 2020, there will be 13 million more men than women between the ages of 25 and 34.

Despite this historic bias toward male children, women are playing an increasing role in the economy. Their participation in the workforce is already high—67 percent compared with 33 percent in India, 48 percent in Japan, 52 percent in Hong Kong, and 58 percent in the United States in 2009. The one-child policy has freed many women from caring for large families, indicating that workforce participation rates will rise further.

Women are certainly using their freedom to aim high: one study found that 76 percent of women in China aspire to top jobs, compared with 52 percent in the United States,⁹ and women are not unusual on the boards of China's A-share listed companies.¹⁰ The number of women working in offices, where pay is better, is also rising. In 2010, 47 percent of working women had an office job compared with 43 percent in 2003.¹¹ Assuming the working participation rate among females continues, we expect more than half of working women will have an office job by 2020.

All of this suggests that the income gap between men and women, already smaller than in many developing countries, may narrow further. It also indicates that women will be increasingly independent and become equal partners in financing their family's purchases, as well as attractive consumers in their own right.

9 Source: "New Study Finds the Solution to China's Talent Crunch is in the Hidden Talent Pool of Educated Chinese Women," by Center for World-Life Policy, March 2011.

10 Source: "Hurun List of Self-Made Women Billionaires," 2011.

11 Source: "New Study Finds the Solution to China's Talent Crunch is in the Hidden Talent Pool of Educated Chinese Women," by Center for World-Life Policy, March 2011.



Understanding the Mainstream Consumer: New Spending Patterns

An understanding of China's changing economics and their impact on the profiles of consumers helps to identify some key trends in spending patterns in the next decade. We discuss four: the high growth in discretionary categories, the tendency toward trading up as consumers spend some of their discretionary income on buying better versions of goods and services, the emergence of a senior market, and evolving geographic differences.

Growing discretionary spending

Higher incomes and government efforts to boost consumption will benefit all consumer-facing companies, although to varying degrees depending on their product portfolios. Discretionary categories will show the strongest overall growth, of 13.4 percent between 2010 and 2020, as a result of these goods becoming affordable to increasing numbers of consumers. Next come semi-necessities (10.9 percent growth) followed by necessities (7.2 percent). These average figures will of course vary significantly by region and city.

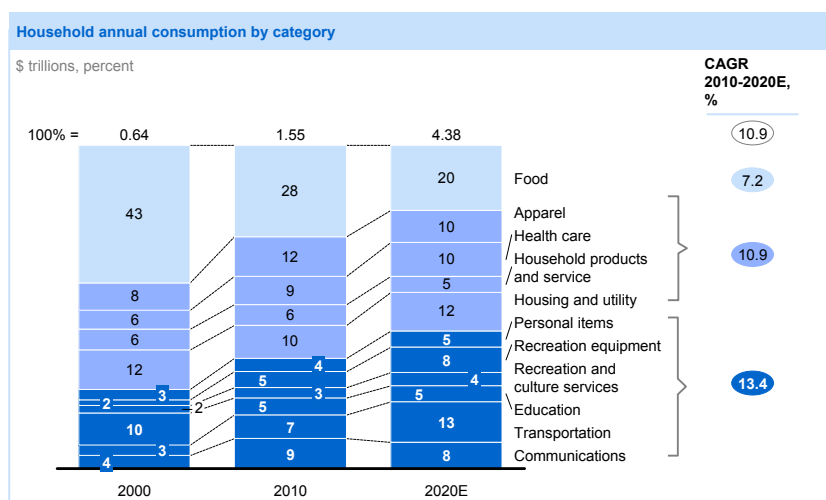
Exhibit 5 shows forecast annual consumption by category for 2020, and the rising importance of discretionary spending. Within each broad category are sub-categories, some of which are more discretionary than others and expected to grow faster. Dining out is an example. As a discretionary category within "Food," dining out is expected to grow by 10.2 percent a year in the coming decade, against 7.2 percent for basic food ingredients.

Exhibit 5

Rising importance of discretionary spending

URBAN CHINA

Necessities Semi-necessities Discretionary



SOURCE: McKinsey Insights China – Macroeconomic model update (March 2011)

It goes without saying that the wealthiest, that is, our affluent-consumer segment, will be the biggest consumers of discretionary items. Less obvious is the extent to which they will be able to afford more of such items in 2020 compared with other income groups as their numbers and the amount of their wealth grow.

Our consumption model suggests that average household spending for value, mainstream, and affluent consumers in 2010 was about \$2,000, \$4,000, and \$12,000 respectively. These figures will jump to \$3,000, \$6,000, and \$21,000 respectively by 2020. So although all consumers will increase their spending, the gaps between different income groups will widen significantly. Stark disparities in standards of living are emerging in China.

Aspirations-driven trading up

The second noticeable trend in spending is trading up, driven increasingly by consumers aspiring to improve themselves, the way they live, and their perceived social standing. Just like their Western counterparts, many Chinese judge themselves and others by what they buy.

Strong, early growth in developing markets derives from large numbers of consumers trying products for the first time. As markets mature, growth relies on consumers buying more goods and services more frequently, and/or trading up to buy more expensive versions of items they already have. This explains why there is little room for growth in some basic-necessity categories, as described above, as many consumers are already able to afford such items and are unlikely to buy a great deal more. But that does not mean no growth at all. Take the market for sauces and condiments. Most people can already afford to buy as much as they need of these items. But the increased attention being paid to health and well-being mean that even here there are trading up opportunities. Sales of olive oils, for example, regarded as healthier than many other vegetable and seed oils, are likely to grow by 15 percent a year in the next five years.¹²

¹² Source: Euromonitor.

Trading-up opportunities also exist within semi-necessity categories, such as apparel, health care, and household products, as more consumers will be able to afford different outfits for different occasions, for instance, or to buy more branded products. As a consequence, brands that have been focused on accessing mass market consumers might need to reposition themselves to appeal to these consumers' now rising aspirations, while newer, younger brands may be able to leapfrog more established competitors by offering premium products and crafting a similar brand image. Global companies too may need to rethink their historical brand positioning given the size of the trading up opportunity in China.

But it is the top end of the market that will most benefit from trading up, with growth at the high end of some consumer goods categories already outpacing average growth for the category. Sales of premium skin care products, for instance, grew by more than 20 percent a year in the past decade against an industry average of 10 percent,¹³ while annual volume growth rates of more than 20 percent are foreseeable for luxury SUV cars, compared with around 10 percent for basic family cars. China had already become a leading luxury market by 2010 and could overtake Japan to become the biggest luxury market by 2015.

Emerging senior market

China's aging demographic means that as a share of the total population, there will be 5 percent more people above the age of 65 in 2020 than there are today. That is an extra 126.5 million citizens, clearly an important consumer segment. But what is equally important is the way in which the spending patterns of older people in 2020 will differ from those of older people now. The pronounced variations shown in our 2011 survey, whereby older people were more inclined to save and less willing to spend on discretionary items such as travel, leisure, and nice clothes, are likely to be much less apparent in 2020.

¹³ Source: Euromonitor.

Most people in China over the age of 55 experienced the harsh conditions of the Cultural Revolution in the late 1960s and early 1970s. Not surprisingly, they think it important not to spend frivolously. Among residents of tier-one cities, 55 to 65-year-old residents allocate half of their expenditure to food and little to discretionary categories: only 7 percent of their spending goes toward apparel, for example. In comparison, those who are ten years younger spend only 38 percent on food but 13 percent on apparel. Indeed, our consumer surveys have revealed that although today's older consumers behave very differently from younger people, today's 45 to 54-year-olds—the older generation come 2020—demonstrate spending patterns similar to those of 34 to 45-year-olds (who allocate 34 percent of their spending to food and 14 percent to apparel). This implies that companies will have to rethink their notion of older consumers.

Evolving geographic differences

The persistence of huge variations in the economic profiles of different cities and city clusters has already been noted, along with differences in spending power. These geographic disparities in spending across clusters will remain significant over the next ten years. While the gap across clusters of sales in basic necessities will narrow as these items become affordable to the vast majority of urban consumers, it will widen for discretionary categories such as consumer electronic products, reflecting differences not just in wealth but taste too. Strong, regional differences in tastes as well as attitudes are not set to disappear in China, which means some regional companies, especially in food and beverages, are likely to dominate locally, helped by strong, regional economies of scale.

These variances in growth potential across geographies suggest an increased need for companies to conduct a granular mapping of opportunities.



Understanding the Mainstream Consumer: Behavioral Patterns

It is of course impossible to try to describe how “the Chinese consumer” might behave as we know there are significant differences in behavior between consumer segments—differences that will only increase given the new demographics. Here, therefore, we focus largely on mainstream consumers, who will represent 51 percent of total urban households by 2020. Historical consumer research shed some light on the unique behavioral patterns of mainstream consumers; changing economic and demographic factors could strengthen or refine these patterns. Over the next decade, mainstream consumers will:

- Continue to be pragmatic despite their growing wealth
- Set greater emphasis on a product’s appeal to their sense of individuality
- Become increasingly brand-loyal
- Change the way they shop, spending less time in physical stores and embracing new channels.

The still-pragmatic consumer

Chinese consumers are renowned for their pragmatism – something that is not about to change despite rising wealth.

The Chinese are conservative spenders who give a great deal of thought to their purchases. Before deciding what they might buy, they tend to fix a budget, evaluate the features they feel are worth paying for, and then hunt down the best deal. Impulse purchases are rare—28 percent of people admit to buying on impulse compared with 49 percent in the United Kingdom.

These attitudes and behaviors are influenced by traditional Confucian values. Given how deeply rooted such values are in Chinese society, we do not see attitudes towards spending shifting significantly in the next decade. Certainly, consumption will rise strongly in line with rapid income growth, and savings rates may well fall. But the Chinese will remain “smart” shoppers because they are willing to spend time and trouble researching purchases. And with price comparisons easier to make, they may become smarter still. Some 48 percent now seek “value for money” as one of their top five considerations when purchasing a mobile phone, for example, compared with 20 percent in 2009.

The individual consumer

As consumer markets mature, so consumers’ expectations rise, and the Chinese are no exception. As new consumers, they sought basic functional benefits such as durability in consumer electronics, comfort in apparel, and taste in food and beverages. Now they are becoming more discerning. Health and well-being, for example, are already cited by the majority of consumers as

important considerations when choosing certain food or drink products, and the same criteria are steadily being applied to items ranging from facial cleansers to laundry detergents. User-friendliness, important to less than a quarter of consumers in 2009 when buying a mobile phone, is an important consideration to almost half now.

By 2020, our research suggests, emotional considerations—particularly whether a product reflects the user’s sense of individuality—will strongly affect the buying decisions of the majority of Chinese consumers. This reflects an evolution in values toward a greater emphasis on self-expression and assertiveness. So, when buying chocolate, for example, only 8 percent of consumers in 2009 thought concepts such as “showing my status” or “this is a brand for people like me” were important. Today that figure stands at 19 percent on average, and 24 percent for wealthier consumers. As incomes grow, so will consumers’ sense of individuality. Indeed, companies will have to consider how to satisfy this desire for individuality in the way they market products not just in high-involvement categories such as cars and personal care, but also in commodity categories such as milk and laundry detergent.

Niche brands are likely to be part of their response. To date, big brands have had a monopoly on success in China, partly because when consumers bought their first fridge, car, or mobile phone, they had little to rely on as an indicator of quality and safety other than a well-known brand name. With more experience and product knowledge, consumers will feel safer trying lesser-known brands—but they will also see purchases of niche brands as a way of setting themselves apart from the crowd.

The increasingly loyal consumer

But what of brand loyalty? Despite their love affair with brands, Chinese consumers to date have been far less loyal than their western counterparts, preferring to choose from among a repertoire of their favorite labels. Only 46 percent (53 percent of those households with monthly incomes of more than \$1,800, equivalent to RMB12,300) say they stick with a particular brand of a product they like, compared with 71 percent in the United States.

The future signs are mixed: our survey data show that the number of brands that any one consumer chooses between has risen of late, although the young and affluent profess greater brand loyalty. That said, it is hard to imagine that brand loyalty will not rise in certain categories as companies increasingly promote the emotional benefits of their products in order to differentiate themselves from competitors in a more mature market, and as consumers become more discerning about what separates brands apart from the label.

At the same time, this growing level of discernment will lead to the emergence of distinct groups of consumers expecting recognition from retailers. It is a

development likely to open up opportunities for retailers' own brands. These cheaper "private labels" now account for 43 percent of total retail sales in the United Kingdom, 28 percent in France, and 17 percent in the United States, but for just one percent in China.¹⁴ If public concerns over product safety are adequately addressed, there is no reason why private-label brands for commodity items would not appeal to China's pragmatic consumers looking for a bargain.

The modern shopper

In the past decade—much later than consumers in many other markets—the Chinese have embraced modern retail formats, treating shopping as a form of entertainment for the entire family rather than just a necessity. The next decade will expose many new consumers to the experience, especially migrants and residents of smaller cities. The love of "retail-tainment" will ebb however, partly because trips to malls will lose their novelty, and partly because other leisure activities will be on offer owing to government efforts to boost the entertainment industry and hence private consumption.

Novelty value in shopping will lie instead with e-commerce. Evolving lifestyles in densely populated cities are strengthening shoppers' demands for convenience, and increasingly e-commerce will satisfy that demand. By 2020, 14 to 15 percent of retail sales will be transacted online, and in some categories, such as consumer electronics, that ratio could be as high as 30 to 40 percent. For groceries, the current figure of less than 1 percent could move closer to the current level of about 10 percent in the United States. Rapid development of shopping applications on mobile devices, online payment systems, and logistics infrastructure will further enable the growth of e-commerce by enhancing convenience and security. The Chinese could become among the most dedicated and sophisticated of online shoppers.

Pragmatic and discerning Chinese consumers will not be satisfied purely with convenience though. Easier price comparisons, unique assortments of products, freshness of goods, quality of service, and a social networking experience will all be sought after. Preferences will be many and varied, making the segmentation of channels more important even as the distinction between online and offline shopping blurs.

14 Source: "Private-Label Global Report, 2011", Nielsen.

Meet the 2020 consumer: how profiles will change

Here we select a few consumers and highlight who they are and how they will spend and shop come 2020. Although each profile provides a general view of prevailing trends, the consumer segments represented each have their own unique characteristics.

Mr Wang (student, born in 1991)



2011

Who he is

- ▶ Aged 21, student in a top university in Hangzhou
- ▶ Born into a middle-class family in Jiangxi. Parents both doctors in a local hospital

What he cares about

- ▶ As a single child enjoys his parents' full attention
- ▶ Wants a well-paid job so he can travel abroad

What he buys

- ▶ Spends half his spare money on dining out and entertainment with friends
- ▶ Just received an iPhone as a birthday gift from his parents

How he buys

- ▶ Buys clothing from Taobao, China's biggest online shopping platform, and groceries from the nearby hypermarket



2020

Who he is

- ▶ Aged 30, single
- ▶ Works at a media company in Hangzhou, earns RMB20,000 a month, and plans to work freelance in a few years

What he cares about

- ▶ Expects more control of his time
- ▶ Enjoys travel and does not want to marry until he has traveled in Africa
- ▶ Rents an apartment, does not want to buy

What he buys

- ▶ Spends 40 percent of his income on entertainment and travel with friends
- ▶ Saves 20 percent of his income so that he can occasionally buy luxury items

How he buys

- ▶ Uses the "spend control" tool in his smart phone to plan his spending on necessities
- ▶ Buys majority of products from Internet with his smart phone
- ▶ Often shops in outlets that have good deals on branded products

Miss Li (urban migrant, born in 1995)



2011

Who she is

- ▶ Aged 17, raised in the Sichuan countryside
- ▶ Left school after junior high and works in a factory in Dongguan

What she cares about

- ▶ Uncertain about her future and whether she can remain in the city without an urban Hukou permit¹⁵

What she buys

- ▶ Saves every penny she can and supports her younger brother's education
- ▶ Occasionally dines out in small restaurants to celebrate festivals or friends' birthdays

How she buys

- ▶ Seeks advice from people she knows but is easily persuaded by in-store sales staff
- ▶ Usually seeks to buy the cheapest products in the store



2020

Who she is

- ▶ Aged 26, single
- ▶ Has moved to Chengdu and works as an administrative staff member in a private company earning RMB4,000 a month (equivalent to \$600). Belongs to "value" segment in terms of income

What she cares about

- ▶ Believes that with hard work she can support herself and her family
- ▶ Wants to settle down in Chengdu and get married soon

What she buys

- ▶ Saves half of her income for an apartment of her own
- ▶ Starts to afford new categories of goods such as cosmetics and trades up to branded items on necessities such as apparel

How she buys

- ▶ Does comprehensive research among multiple sources, including online and offline, media and physical stores
- ▶ Seeks the best price on the product that has the functional benefits she needs

¹⁵ A local residency permit that enables the holder to use government services. People in rural areas or small cities often seek a Hukou permit to live in bigger cities because of the better social welfare benefits.

Ms Cai (working mother, born in 1980)



2011

Who she is

- ▶ Aged 32, married with three-year-old son, lives and works in Beijing

What she cares about

- ▶ Expects a higher position at work
- ▶ Wants to create good study and living environment for her son

What she buys

- ▶ Just bought a family car
- ▶ Saving to pay off the mortgage

How she buys

- ▶ Shops in a hypermarket once a week for food and household products
- ▶ Shops online occasionally, mainly for apparel



2020

Who she is

- ▶ Aged 41, senior manager at a large company

What she cares about

- ▶ Needs more quality hours with her family
- ▶ Wants to stay young and healthy
- ▶ Worries about the health of her parents and parents-in-law

What she buys

- ▶ Plans annual family vacation
- ▶ Buys advanced skin care products and spa treatments, and selects premium brands

How she buys

- ▶ Shops online with her smart phone on her way to and from work. Orders prepared food online when she leaves the office and has it delivered when she gets home
- ▶ Shops in neighborhood stores because it is quicker than traveling to the hypermarket

Mr Zhang (middle aged, born in 1964)



2011

Who he is

- ▶ Aged 48, lives with his wife, 20-year-old son, and his 70-year-old mother in Fuzhou

What he cares about

- ▶ Tries his best to provide a better education for his son
- ▶ Thinks it's his children's responsibility to care for aging parents

What he buys

- ▶ Saving for an apartment for when his son gets married
- ▶ Buys branded apparel for himself only for big occasions (such as his mother's seventieth birthday celebration)

How he buys

- ▶ His wife is the primary shopper, and the family goes to the hypermarket every weekend for some fun
- ▶ The family buys food mainly from the traditional "wet market" and apparel from department stores



2020

Who he is

- ▶ Aged 57, expects to retire soon from the trading company where he has worked for more than 20 years
- ▶ Spends significant time caring for his two-year-old grandson

What he cares about

- ▶ Accepts the idea of care homes for the elderly and does not expect his son to support him when he grows old
- ▶ Plans some domestic and international travel to enjoy life after retirement

What he buys

- ▶ Has a medical check-up every year and just joined a gym club for seniors
- ▶ Buys organic food for his grandson

How he buys

- ▶ His wife is still the primary shopper of the family and they have learned to shop online



Preparing for the 2020 Consumer: Implications for Companies

Companies that want to drive their global growth by taking advantage of the immense opportunities presented by China's developing consumer markets will need to be bold in their aspirations and willing to reformulate their strategies accordingly.

Strategic imperatives

The trends outlined above present a set of strategic questions. How important is the Chinese market to your company? How committed are you to adjusting your portfolio to capture the highest growth? How important are regional differences in your business? And how are you going to serve increasingly heterogeneous consumer segments?

The precise decisions and actions required will differ by category and company. However, three themes are particularly important for consumer-facing industries.

Drive global growth from China using the mainstream consumer as a testbed

The biggest challenge today is not whether a company can continue to grow in China, or grow faster in China than in other regions of the world, but whether it can build and sustain a leading position in China and, in the case of multinational companies, whether China can drive global growth. In fact, as the country with the largest group of mainstream consumers worldwide, China could be a perfect testbed for companies that serve this consumer segment. Our analysis indicates huge variations in the likely growth rates of companies operating in China come 2020 depending on the product category, consumer segment, and geography. Yawning gaps could open up between companies that have similar turnovers today but different degrees of focus on the best growth opportunities.

Looking to 2020, it will be crucial for companies to define where to compete— by specifying geographies, market segments, and categories—and to invest ahead of others to ride the highest growth waves. This might entail adjusting not just the Chinese portfolio but also the global one. So entrenched in China is the US fast-food restaurant operator Yum! Brands, for example, that it now earns more than 40 percent of its global operating profit there and is introducing its Chinese product innovations in other countries. Coca-Cola entered the packaged milk-shake category in China with an innovation, its Minute Maid Pulpy brand, and has since launched the product in more than 20 countries, building a brand worth \$1 billion.

Given the dynamic nature of China's market, a regular review of portfolios to ensure that resources, capital and human, are allocated to capture the highest growth potential must become a management priority. Active re-allocation of resources—to introduce new categories, serve new consumers, and deepen penetration, for

example — should be accelerated if companies want to stay at the frontiers of growth.

Decentralize decision-making to capture the huge and increasingly disparate regional markets

China is so vast and its regions are so diverse that companies ought to treat it almost as a collection of separate countries. Many companies spend as much time on their marketing plan for Finland as they do on their plan for China, and as a result the latter is not very good. In the global hierarchy, China should rank as more than just one country and its regions command more attention than they currently receive. To this end, companies need to redefine the roles of their regional divisions and headquarters, delegating more decision-making power to the former.

Many companies already operate with three, five, or even more regional bases, but they tend to function only as sales offices, executing instructions received from the top. Consumer needs could become so varied across regions that local insight and strategic decision-making power will be vital. Regional offices should therefore be given full responsibility for their own profit and loss accounts, strategic planning, consumer research, innovation, tailoring of the portfolio, development of the route-to-market model, and marketing. The corporate center will continue with a redefined role of serving the individual units and safeguarding the company's brands, but with less power and at lower overhead cost.

Narrow the definition of “target consumer segment” and use a portfolio of brands and sub-brands to appeal to consumers’ individuality

Undifferentiated mass consumption and the rising cost of advertising have made the scale of a brand or product crucial to its success in the past decade. Companies used to provide the same value proposition — usually framed around products’ functional benefits — to all types of consumers, while stretching brands across product categories and price tiers to leverage scale and garner market share.

Over the next decade the game will change to take account of the emergence of different categories of consumers and their own sense of their differences and individuality. Companies will need the crispest value propositions to connect with each group and to stand out from competitors. By 2020, brands (or sub-brands) will have to be positioned to target narrower consumer segments and offer more tailored value propositions. Those brands that have been extended across too many consumer segments and price points may struggle to maintain a defensible market position. Hard though the transition may be, at some point, companies that have been focused on maximizing the scale of their brands will have to move to a model based on a portfolio of more targeted brands or sub-brands to connect with different consumer segments.

A “consumer-centric” approach is required to make sure all decisions start from understanding and serving the target segment. Investment in gathering consumer insights, along with frank assessment of a company’s strengths, will reveal the best value proposition for each segment. The portfolio can then be adjusted and more brands and sub-brands gradually introduced.

Growth enablers

Each of the strategic implications above comes with its own set of organizational and operational implications. Companies will have to manage more complexities within their organization, IT infrastructure, and supply chain, while securing talent of sufficient caliber to achieve their growth aspirations.

A few forward-looking companies are taking specific steps toward building diverse and more resilient supply chain assets.¹⁶ First, they are splintering their traditional monolithic supply chains into smaller, more flexible ones. Second, they are treating their supply chains as dynamic hedges against uncertainty by regularly examining — even reconfiguring — their broader supply networks with an eye toward economic conditions five or ten years ahead.

Demand for talent will be considerable at all levels, particularly senior and middle management, given the capabilities required. These include not only strategic thinking and execution, but also the ability to understand consumers in each regional market and a willingness to be located outside typical tier-one cities. Companies will have to devise a strong value proposition and clear strategy for recruiting, developing, and retaining talent to prepare for the challenges ahead.

McKinsey’s study of the development of China’s consumer spending and behavior over the past five years has pointed to trends that would have been hard to predict five years ago. There was little to suggest then that there would be more significant differences in behavior between regions than between tiers of cities, for example, or that consumers would continue to be pragmatic and eager to look for the best deal despite the growth in incomes over time.

No doubt the market and consumer behavior will take some unexpected turns over the next decade. Nonetheless, our research reveals a clear direction that companies might follow. To make sure they accompany consumers on that journey, companies should start getting acquainted with the 2020 consumer today.

16 Source: “Building the supply chain of the future,” by Yogesh Malik, Alex Niemeyer, and Brian Ruwadi, The McKinsey Quarterly, January 2011.

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McKinsey Insights China

McKinsey Insights China provides businesses with the data, analytics and rapid, customized problem-solving and decision-making support to help build robust strategies for China's rapidly changing marketplace. The data and analysis combine results from McKinsey's annual Chinese consumer studies with proprietary macroeconomic and demographic data and analysis from the McKinsey Global Institute (MGI).

McKinsey Insights China updates the macroeconomic models regularly – the national model every six months and city level model annually to retain the most recent view of the Chinese market at a highly granular level. These frequent updates ensure that the latest economic activities and policy changes are reflected in our forecasts of demographic, economic and consumption variables at the individual city level.

Since 2005, we have conducted the largest study of Chinese consumers on an annual basis. We have interviewed more than 60,000 Chinese consumers across over 60 cities, giving us a deep understanding of Chinese consumers' attitudes and spending behavior in more than 100 product categories. The respondents come from a wide range of incomes, ages, regions, city-clusters and city-tiers, and represent 74 percent of China's total GDP and 47 percent of the total population.

In 2008 and 2010, we conducted additional studies of over 3,200 wealthy consumers with annual household incomes in excess of RMB 250,000, giving us unprecedented insight into the behavior of this fast expanding and economically important segment.

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